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IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

W. P. MCDONALD,
Petitioner,

v.

BRANIFF AIRWAYS, INC., *et al.*,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

JAMES L. HICKS, JR.
HICKS, GILLESPIE, JAMES & LESSER, P.C.
740E-1341 W. Mockingbird Lane
Dallas, Texas 75247
(214) 630-8621
Attorneys for Petitioner

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

40pp

QUESTION PRESENTED

The sole issue before the Court is whether the courts below erred in selecting the formula for calculation of retired pilots' pension benefits under 29 USC section 1344 upon the termination of the Braniff pilot pension plan.

LIST OF PARTIES

Airline Pilots Association International

Braniff's Airways, Inc. Retirement Plan for Pilots Part A

Dale States

Jack Boisen

John Skiba

Richard Russell

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

W. P. McDonald, class representative below, hereby petitions for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit, enabling this Court to review the judgment in W. P. McDonald vs Braniff Airways, Inc., et al. (Fifth Circuit No. 83-1531 as decided on April 3, 1984). The opinions of the United States Bankruptcy Courts of the Northern District of Texas and the United States District Court of the Northern District of Texas are not officially reported and are reprinted as Appendices A and B to this petition. The Court of Appeals for the Fifth Circuit affirmed the opinion of the District Court *per curiam* without a written decision. Accordingly no Fifth Circuit decision is appended.

JURISDICTION

The judgment of the Court of Appeals for the Fifth Circuit was issued on April 3, 1984. On July 5, 1984, Justice White signed an order extending the time for filing a petition for a writ of certiorari to and including August 6, 1984 (Appendix C). This Court has jurisdiction pursuant to 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

The statutory provisions and regulatory provisions are reprinted in Appendices D & E.

STATEMENT OF THE CASE

Throughout the proceedings in the Bankruptcy Court, District Court and Court of Appeals the parties have concurred that there is no dispute over the material facts. Those facts are detailed in both the memorandum opinions of the Bankruptcy and District Courts. (Appendices A and B, respectively).

This case grows out of the much publicized bankruptcy of Braniff Airways, Inc. The pilots of Braniff Airways were covered by a pension plan referred to as the "Pilot's A Plan" (the "Plan"). The amount of benefits under that plan was negotiated between Braniff and the collective bargaining representative of its pilots, Airline Pilot's International ("ALPA"). In November 1976 ALPA negotiated a collective bargaining agreement with a retroactive effective date of August 1, 1976, which provided for prospective increases in the level of benefits to be paid under the plan. At the time of those negotiations retiring pilot's benefits under the plan were calculated at $14,400.00 per year plus $250.00 for each year served in excess of twenty (20) years (the "$14,400.00 formula"). During those negotiations ALPA secured an agreement from Braniff which among other things raised benefits to $16,400.00 per year plus $250.00 for all years served

in excess of twenty (20) which was to be paid beginning January 1, 1978 ("$16,400.00 formula"). ALPA and Braniff also agreed that on May 1, 1979, benefits would be increased to forty percent (40%) of average earnings (the "40% formula").[1]

The negotiated increases also provided that any pilot retiring after August 1, 1976 would receive the increased benefits as they came into effect thereafter in January 1978 (the $16,400 formula) and May 1979 (the 40% formula).

Under the Employee Retirement Income Security Act (ERISA) the Pension Benefit Guarantee Corporation (PBGC) guarantees certain levels of plan benefits to participants of terminated pension plans. The guaranty extends through the first four statutory categories defined in 29 U.S.C. § 1344 (Appendix D). A plan is "sufficient" when it has sufficient plan assets allocable under Section 1344 to pay the first four benefit levels.[2] All parties agree that if the $14,400.00 formula is utilized for the determination of benefits upon plan termination as the benefit of the third category of benefits, § 1344(a)(3), the plan assets are sufficient. If on the other hand the 40% formula is employed, the plan is in all probability insufficient. If the plan is rendered insufficient as a result of application of the 40% formula, the guaranteed levels of benefits are paid from plan assets supplemented by Pension Benefit Guaranty Corporation reserves.

The issue is a single one submitted to the Bankruptcy Court, the District Court and the Court of Appeals for the Fifth Circuit. The question to be resolved is which of the two formulas (40% or the $14,400.00) should properly be used in allocating plan assets to the third

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[1] The "40% formula" provides with few exceptions that pilots were to receive 40% of their highest monthly earnings in any 12 consecutive months of the pilot's last 5 years of employment.

[2] See 29 U.S.C. §§ 1322 and 1361.

category of benefits, 29 U.S.C. § 1344(a)(3). Appellant believes that each of the courts below erroneously selected the $14,400.00 formula in violation of the plain language of the statute.

As a result of the application of the $14,000.00 formula by each of the courts below retired pilots lost as much as two-thirds of the benefits that they had been receiving prior to termination of the plan.

REASONS FOR GRANTING THE WRIT

Obviously, the issue presented in this case is a narrow one. The issue is one of first and potentially only impression. Despite these factors mitigating against consideration by this Court two important considerations warrant granting this petition.

First, despite the fact that ERISA was enacted to protect pensions through statutory safeguards and PBGC insurance, the retired Braniff pilots represented by Petitioner have been caused to lose as much as two-thirds (2/3rds) of their pension benefits. That loss is the result of a statutory interpretation discussed hereafter which defies policy, reason and the language of the statute. An important federal pension policy is at stake as well as interpretation of this federal statute.

Second, the decisions of the Court below interpreting 29 U.S.C. § 1344(a)(3) are palpably wrong. That is, that statutory provision requires use of that plan benefit level which meets three statutory criteria each of which is met by the "40% formula": (1) the benefit must have been in pay status for a three (3) year period on the termination date of the plan; (2) the plan provisions providing for the benefit must have been in effect for a five (5) year preceding the termination of the plan; and (3) the benefit must be the lowest benefit paid during the three year preceding termination of the plan. Having failed to recognize that the 40% formula meets each of these criteria, the courts below engaged in plain error.

There is no dispute as to the existence of requirements (1) and (3).[3] That is, any participant retiring after August 1, 1976 has received a benefit calculated upon the 40% formula since May 1, 1979 (i.e. for more than three years preceding the date of determination (August 30, 1982)). Likewise, the lowest benefit for any participant during that same three-year period has obviously remained the same as calculated under the 40% formula. Hence (1) and (3) are indeed satisfied.

Requirement (2) was the one troublesome to the courts below and upon which we believe those courts erred. That is, to qualify for use the plan benefit must have been "in effect" for five years preceding termination. We believe the facts demonstrate that the 40% formula complies. The upgrading to the 40% formula was agreed upon between the ALPA and Braniff in November 1976 (effect retroactively for those retiring after August 1, 1976). By the terms of the agreement the increase to the 40% formula occurred later on May 1, 1979 (again, retroactively for all retiring after August 1, 1976). Consequently, the plan provision requiring the 40% formula has been "in effect" since at least November, 1976 and hence for more than five years.

Obviously, the five year requirement is intended to guard against plan administrators providing for gigantic benefit increases knowing that such increases cannot be actuarily funded and that plan termination is imminent. If such manipulations were countenanced by ERISA, the PBGC would be subject to assuming obligations for huge guaranteed benefits in purposely underfunded plans. None of these fears exist here. In 1976, Braniff and ALPA provided for plan increases in good faith and with an eye to the plan continuing indefinitely. Consequently, there is no policy basis upon which to apply the

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[3] i.e. By order of the Bankruptcy Court the plan was terminated effective August 30, 1982 (Appendix F).

five year "in effect" rule to defeat application of the 40% formula.

In an apparent effort to render its definition of "in effect" as concerns automatic benefit increases like the 1978 and 1979 increases involved here, the PBGC issued 29 CFR 2618.13 (Appendix G). Specifically, 2618.13(b)(5) permits automatic benefit increases payable in the fourth and fifth years preceding termination to be included in the category three benefit if: (a) the plan provision requiring the automatic increases was adopted and effective before the beginning of the five year period preceding termination; and (b) the increases are applicable to both active participants (non-retirees) and those in pay status (retirees receiving benefits), or to retirees only. Requirement one is met—the increases were adopted in November 1976.

The facts show that the increases to the $16,400.00 and 40% formulas were applicable to all pilots retiring after August 1, 1976, but not to those retiring before that date. Consequently, these increases were applicable to all non-retirees and *some* retirees (i.e., those retiring after August 1, 1976). However, nothing in the regulation requires that increase be for *all* retirees—only that it be applicable to those in pay status.

In an effort to assure the sufficiency of the plan and avoid requiring PBGC to assume the deficiency, the courts below supplemented the regulation to require that the increases be applicable to *all* retirees.

Courts do not write statutes or regulations. Courts only interpret them when required. Interpretation however, does not include adding words or phrases to reach a desired result. Indeed, it is axiomatic that the absence of limiting words by a drafter implies the absence of intent to limit. Here, the PBGC did not write "*all*" in its regulations and it must be inferred that it intended

what it wrote—only that to qualify the benefit must be payable to retirees. These facts meet that qualification.

The interpretation of the statute and the regulations below is plainly erroneous. For these reasons a writ of certiorari is required.

CONCLUSION

For the foregoing reasons the petition for a writ of certiorari should be granted on the issue presented.

Respectfully submitted,

JAMES L. HICKS, JR.
HICKS, GILLESPIE, JAMES & LESSER, P.C.
740E-1341 W. Mockingbird Lane
Dallas, Texas 75247
(214) 630-8621
Attorneys for Petitioner

APPENDICES

APPENDIX A

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
FORT WORTH DIVISION

Case No. 482-00369

Adversary No. 482-0337

IN RE BRANIFF AIRWAYS, INC., *et al.*,
Debtors

BRANIFF AIRWAYS, INC., AIR LINE PILOTS ASSOCIATION, INTERNATIONAL; BRANIFF AIRWAYS, INC., RETIREMENT PLAN FOR PILOTS, PART A, DALE STATES, JACK BOISEN, JOHN SKIBA AND RICHARD RUSSELL, CONSTITUTING THE RETIREMENT BOARD OF BRANIFF AIRWAYS, INC. RETIREMENT PLAN FOR PILOTS, PART A,
Plaintiffs,

v.

BANKERS TRUST COMPANY AS TRUSTEES; AND W. P. MCDONALD, DANIEL P. HULSEY, GERALD S. ROSS AND N. G. ROBSON AND V. A. QUATTLEBAUM ON THEIR OWN BEHALF AND ON BEHALF OF ALL PLAN BENEFICIARIES, AND PENSION BENEFIT GUARANTY CORPORATION,
Defendants.

ORDER REGARDING BENEFIT COMPUTATION UNDER ERISA SECTION 4044

The Court having considered the briefs and arguments of the parties, and having issued its Memorandum Opinion in this matter on December 10, 1982, it is HEREBY ORDERED THAT:

For purposes of section 4044(a)(3) of the Employee Retirement Income Security Act of 1974, 29 U.S.C. § 1344(a)(3), benefits under the Braniff Airways, Incorporated Retirement Plan for Pilots, Part A ("Plan") shall be calculated for Plan Participants who would, under the terms of the Plan, be eligible for benefits under Plan section 8.4(c), under the "$14,400 formula," *i.e.*, the formula providing a Normal Retirement Age annual benefit of $14,400 plus $250 for each year (adjusted for completed months) of the Participant's Service in excess of twenty (20) years.

/s/ John Flowers
JOHN FLOWERS
United States Bankruptcy Judge

Dated: January 28, 1983

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
FORT WORTH DIVISION

Case No. 482-0369

Adversary No. 482-0337

IN RE BRANIFF AIRWAYS, INCORPORATED *et al.*,
Debtors

BRANIFF AIRWAYS, INCORPORATED; AIR LINE PILOTS ASSOCIATION, INTERNATIONAL; BRANIFF AIRWAYS INCORPORATED, RETIREMENT PLAN FOR PILOTS, PART A; DALE STATES, JACK BOISEN, JOHN SKIBA, and RICHARD RUSSELL, CONSTITUTING THE RETIREMENT BOARD OF BRANIFF AIRWAYS, INC. RETIREMENT PLAN FOR PILOTS PART A,

Plaintiffs,

v.

BANKERS TRUST COMPANY, AS TRUSTEE; and W. P. MCDONALD, V. A. CEBELL, III, N. G. ROBINSON, and V. H. QUATTLEBAUM ON THEIR OWN BEHALF AND ON BEHALF OF ALL PLAN BENEFICIARIES,

Defendants.

[Filed Dec. 23, 1982]

MEMORANDUM OPINION

This case involves several issues concerning the Braniff Airways Incorporated Retirement Plan for Pilots, Part A ("Plan"). The debtor brought this action pursuant to § 4048 of the Employee Retirement Income Security Act ("ERISA"), 29 U.S.C. § 1348, seeking a court ordered date for termination of the Plan. The debtor also re-

quested instructions as to its fiduciary responsibilities pursuant to § 502 of ERISA, 29 U.S.C. § 1132. The case has been certified as a class action and the named defendants are representatives of their respective classes. This court has jurisdiction under 28 U.S.C. § 1471.

The issues before the court are: the date of plan termination; whether certain participants are entitled to lump sum distributions from the Plan; whether a group of participants, who became employees of the debtor by reason of a merger of the debtor with Pan American-Grace Airways, Inc. ("Panagra"), are entitled to segregation of specific assets which were transferred to the plan from the Panagra retirement plan; and the effective date for determining participants' marital status for purposes of certain actuarial calculations.

BACKGROUND

For many years the debtor has maintained a pension plan for its pilots. The plan in question is a defined benefit plan providing specific benefits to be paid to plan participants. As such it is subject to the provisions of ERISA. 29 U.S.C. § 1321. The Plan was originally established in 1957. Prior to January 1, 1967 participation was voluntary and participants' contributions were made with their after-tax earnings. In 1967 all pilots with one year of service automatically became participants and contributions to the Plan were no longer deducted from their earnings. Thereafter all contributions were made by the debtor for each participant but a portion, namely the "deemed employee contribution", was treated as if each participant had made it. The "deemed employee" contributions were calculated on the participant's earnings, and credited to an account maintained for each participant known as his Contribution Account A ("Employee Contribution Account"). Participants did not pay income taxes on these contributions. A small group of pilots participated in the plan prior

to 1967 and they undisputedly have benefits derived from contributions made from their after tax earnings. The debtor was required to make such additional contributions as necessary to provide the promised benefits and satisfy the minimum funding requirements established by the Internal Revenue Code. The only other source of plan funding has been from earnings on plan investments.

Participants' interests in the Plan are expressed in terms of "Accrued Benefits". Total Accrued Benefits are computed by means of a mathematical formula based upon a hypothetical retirement income for each participant. The Employee Accrued Benefit is also calculated by a formula using the respective Employee's Contribution Account as its base.[1] The Employer Accrued Benefit is calculated by subtracting the Employee Accrued Benefit from the Total Accrued Benefit. All participants are fully vested at all times in their Employee Accrued Benefit. They become 50% vested in their Employer Accrued Benefit after five years service, acquiring an additional 10% for each additional year of service.

A participant's right to be paid from the fund is dependent upon his length of service. Participants with less than five years service are only entitled to a lump sum payment equal to the amount of their Employee Contribution Account upon final termination of employment. Those participants with five years or more service are entitled to receive a retirement income expressed as a percentage of certain earnings. They also have the right to elect a lump sum distribution equal to their Employee Accrued Benefit in the event of termination

---

[1] These are different expressions of the same value. When referred to as the Employee's Contribution Account it is expressed as a lump sum and when referred to as the Employee's Accrued Benefit it is expressed as an annuity.

of employment. This election must be made before retirement and it reduces their future retirement income to the vested portion of their Employer Accrued Benefit.

The plan does not contain any specific provisions regarding the plan administrator's duties in a situation as is presented here. Section 19.4 of the plan generally provides that in the event of plan termination all assets shall be distributed in accordance with § 4044 of ERISA.

The debtor employed 1,966 pilots who were plan participants, some of whom were on furlough, when on May 12, 1982 it ceased all operations and notifie all employees they were terminated. On May 13, 1982, the debtor filed a petition under Chapter 11 of the Bankruptcy Code. Throughout the summer the debtor discussed the status of the plan with the Pension Benefit Guaranty Corporation ("PBGC"). During this time several participants, some with less than five years service requested lump sum payments. These requests were processed but not paid, although all monthly retirement benefits continued to be paid at promised levels. On August 20, 1982 the plan administrator notified all participants of its intent to terminate the Plan retroactively as of May 12, 1982. Simultaneously the plan administrator brought this action.

The Plan does not have adequate assets to pay all participants at promised levels. Under ERISA a plan is considered "sufficient" for PBGC purposes if it has assets adequate to pay the first four priority categories set forth in the statute even though it may not be able to pay all promised benefits. The Plan here meets that test of sufficiency and has assets to meet some but not all fifth priority liabilities. No sixth priority liabilities will be paid. After a preliminary hearing on August 26 and 27, the level of retirement benefits being paid to retirees was ordered reduced to PBGC minimums and lump sum distributions enjoined. Because it is short of assets, lump sum distributions will have the effect of exacerbating the

reduction of benefits for all other participants while giving the lump sum claimants with less than five years service full payment of their promised benefits. Those participants with more than five years service would receive full payment of the employee accrued benefit portion of their promised benefit.

ERISA, which became effective in 1974, was enacted to provide some measure of security to pension plans. Under its provisions a plan may be terminated at any time. 29 U.S.C. § 1341. The termination procedures of ERISA have been the subject of analysis in a companion case involving the pension plan of the debtor's management employees. See my memorandum opinion of November 9, 1982, in adversary number 482-0339. In cases as here, where a plan is sufficient, ERISA provides for the plan administrator to conduct the dissolution of the Plan. 29 U.S.C. § 1341(a). Plan assets are to be allocated to participants depending upon where various parts of their respective benefits fall within the system of priority levels established in the statute. Funds contributed by participants have the two highest priorities, followed by retirement income to those actually retired or eligible for retirement three years prior to plan termination. The fourth priority category is composed of all other benefits guaranteed by the PBGC. The fifth is all other benefits which are non-forfeitable under the plan. The final category is any remaining plan benefits. Plan assets are to be used to pay all claimants in the highest priority category in full before proceeding to the next lower one. If the assets are insufficient to completely compensate all participants for the value of their benefits within a particular category they are allocated on a pro-rata basis. See 29 U.S.C. § 1344. The customary method for distributing the assets is to purchase commercial annuities. A participant may have benefits which fall into more than one of the priority categories. In summary, a participant's benefits under the plan are categorized into the

statutory priorities, valued, and then distributed by purchasing an annuity of which the participant is the beneficiary. Typically, the annuity has several settlement options.

TERMINATION DATE

Since ALPA, the bargaining agent for the pilots, and the debtor agree the plan should be terminated it is not necessary to address the issue of whether the terms of the collective bargaining agreement preclude termination.

On the question of plan termination I have previously ruled, in the companion case involving the debtor's management plan, that where, as here, a plan is sufficient under ERISA it cannot be terminated earlier than ten days after notice of termination is given to all participants. See 29 U.S.C. § 1341. In this case that notice was given on August 20, 1982, and accordingly I set the termination date of the Plan to be August 30, 1982.

LUMP SUM CLAIMS

The selection of August 30 as the termination date makes relevant for discussion the claims of some participants for lump sum distributions. Those claimants fall into two general categories, those participants having less than five years service and those with more. Those with less than five years service point out that their employment was terminated on May 12 and the Plan continued in effect until August 30. They rely upon section 10.4 of the Plan which provides for a lump sum distribution in an amount equal to the Employee Contribution Account for any participant terminated short of five years service. Those with more than five years service rely upon their right under section 10.5 of the Plan to elect to receive a lump sum distribution equal to their Employee Accrued Benefit upon termination of their employment. As noted earlier, the Plan provides the latter group must receive a reduced retirement income in the event of a lump sum distribution.

The debtor, the PBGC and all other parties object to any lump sum distributions because they would constitute a distribution in anticipation of plan termination which violates both the ERISA mandated system of priorities and regulation 2618.4(b) of the PBGC. The pertinent portions of the regulation provide:

> (b) Distributions in anticipation of termination. A distribution, transfer, or allocation of assets to a participant or to an insurance company for the benefit of a participant, made in anticipation of plan termination, is considered to be an allocation of plan assets upon termination, and is covered by paragraph (a) of this section. In determining whether a transfer, or allocation of assets has been made in anticipation of plan termination PBGC will consider all of the facts and circumstances including—
>
> (1) Any change in funding or operation procedures;
>
> (2) Past practice with regard to employee requests for forms of distribution;
>
> (3) Whether the distribution is consistent with plan provisions; and
>
> (4) Whether an annuity contract that provides for a cutback based on the guarantee limits in Part 2621 of this chapter could have been purchased from an insurance company.

29 C.F.R. § 2618.4(b) (1981)

The lump sum claimants respond that distributions in anticipation are prohibited in instances where collusion exists between the plan administrator and some plan participants. They correctly point out there is no evidence of collusion here. This view of the regulation is too narrow although certainly that would be prohibited. It is apparent from §§ 4044 and 4045 of ERISA, 29 U.S.C. § 1344, 1345, that Congress established certain priority policies

regarding protection of pension plan benefits. Those priorities, as described earlier, are found in § 4044. Section 4045 provides for recapture of certain distributions made within three years of plan termination which result in a distribution contrary to the statutory scheme, regardless of intent. The regulation merely expresses that which is implied by the statute.

The purpose of the Regulation is to maintain the respective positions of the participants in a plan's assets and prevent a run on the bank. This purpose is best served by interpreting the Regulation to prohibit claims for distribution which are made at a time the participants know or should know that plan termination is a likely prospect. Because of the nature of pension plans, where each individual has a different interest, it may be impossible to fashion a rule to cover all situations and some windfalls may be inevitable. The discretionary recoupment provisions of § 4045 of ERISA also provide a means to address this problem.

An examination of the facts is necessary to ascertain if the lump sum claims are made in anticipation of termination. As noted, the test is an objective one based upon all the facts and not a subjective one based upon statements of intention of the particular participants involved.

The facts here reveal that the debtor ceased operations and gave notice of termination of employment to all of its employees on May 12, 1982. Uncashed pay checks were not honored thereby leaving all employees unpaid for the last payroll period. On May 13, after the debtor filed its petition for reorganization under the bankruptcy laws, its chief executive officer publicly stated Braniff was "dead", advised former employees to seek other employment and stated that pensions might be reduced. These statements were widely circulated by the news media. On June 10, ALPA notified all of its members of potential problems with their pension plans.

Referring to the circumstances mentioned in the regulation as being relevant, it appears that of May 12, 1982, a change in funding had occurred in that Braniff was no longer operating or funding the Plan and would not likely be able to do so in the future. The evidence revealed that historically there had been very few applications for lump sum distributions even with numerous participants on furlough in recent years. In the two months following the filing of the bankruptcy case 155 lump sum applications were filed. An additional 32 were filed after August 20, 1982. At time of trial 144 remained pending, the others having been withdrawn. The requested lump sum distributions, while authorized by plan provisions in ordinary situations, are contrary to the plan administrator's duty not to discriminate in favor of any group of participants in the extraordinary situation presented here. 29 U.S.C. § 1344. This same responsibility is also found in § 13.1 of the Plan. I find the requests for lump sum payments were made in anticipation of termination of the Plan.

The lump sum claimants cite PBGC Op. Letter No. 78-24 in which it was held that death benefits due a participant who died two years prior to a plan termination date must be paid in a lump sum before the § 4044 allocation of assets is undertaken. From this the lump sum claimants reason that their claims are not made in anticipation of termination because before termination occurs funds must be allocated to satisfy obligations arising prior to the termination date. They assert that one of those obligations is their lump sum claims. This argument is wide of the mark. The issue remains one of distribution in anticipation of termination. It is difficult to see how a lump sum claim that arises by reason of the death of a participant can ever be one in anticipation of termination.

Finally, these claimants assert that payment of the lump sums they seek would not be in violation of the

ERISA priority scheme and thus not be subject to the rule prohibiting distribution in anticipation of termination. They claim they fall into the second priority category, which is the highest priority category applicable to any participant's benefits, and there are sufficient assets to pay this category in full, including all lump sum claims. Priority category two of ERISA provides:

> (a) . . .
>
> (2) Second, to that portion of each individual's accrued benefit which is derived from the participant's mandatory contributions
>
> . . .

29 U.S.C. § 1344(a)(2)

The lump sum claimants argue that the benefits which they seek are derived from their mandatory contributions. They claim these contributions were part of their wages and it makes no difference that they were not taxed on them. In support they cite § 414(h) of the Internal Revenue Code which provides that ". . . *for purposes of this title* any amount contributed . . . to an employee's trust described in § 401(a) shall not be treated as having been made by the employer if it is *designated* as an employee contribution." (Emphasis added).

Section 414(h), is expressly limited to Title 26, the Internal Revenue Code. Moreover, it does not provide such designated contributions shall be treated as employee contributions but rather that they shall not be treated as employer contributions. To interpret it to convert employer contributions into employee contributions for purposes of § 1344 of Title 29, ERISA, would upset the carefully considered Congressional policy of priorities and extend § 414(h) beyond its purpose and context.

Section 6.1(b) of the Plan provides:

> Effective January 1, 1967, no regular contribution under this Sub-Section 6.1, payable to Trust Fund A,

> will actually be deducted from the Participant's Earnings. For the purposes of Sub-Section 6.2, however, it shall be assumed after such date that each Participant has made a monthly contribution to Trust Fund A of an amount determined under the foregoing Sub-paragraphs (a) and (b). The affect of the preceding sentence is to provide for each Participant, beginning January 1, 1967, cash vesting for purposes of refunds at death and termination, in Company contributions to Trust Fund A of amounts equal to the contributions described in the foregoing Sub-paragraphs (a) and (b).

The express purpose of this section is to provide for "cash vesting" of certain plan contributions even though made by the employer and not to change the priority scheme of § 1344. Section 6.1 does not designate the contributions as employee contributions. The legislative history of § 414(h) states that its purpose is to give ". . . effect to the source of contributions, as designated in the plan." H.R. Rep. No. 97-807, 93rd Cong., 2nd Sess. 145. I hold that priority category two of § 1344 is limited to after tax earnings contributed by a participant and only those benefits in that category are entitled to lump sum distributions. The effect of holding as urged by the lump sum claimants would be devastating to the priority scheme of ERISA because it would elevate benefits of younger workers who have not yet retired over those of retirees. A result clearly contrary to Congress' intent.

The remaining question concerns which priority category applies to the benefits of the lump sum claimants with less than five years service. Under § 19.8 of the Plan they are non-forfeitable. I have held that they are not category two benefits and, because they are not payable as an annuity to a participant eligible to retire within three years of termination, I hold that they are not category three benefits.

Priority category four of ERISA includes all other benefits whose payment is guaranteed. 29 U.S.C. § 1344 (1) (4). Section 1322(b) (3) which guarantees benefits, limits the guaranty to those having an actuarial value which does not exceed a specified cap. The PBGC argues that a benefit must be an annuity in order for it to fall within priority category four. The statute does not contain this requirement and the PBGC's argument is based upon §§ 2613.2 and 2613.3 of their Regulations which define guaranteed benefits to be pension benefits, i.e. an annuity. Since no party challenges this position, it is not necessary that I rule on the validity of the Regulation and I will assume for purposes of this opinion that a benefit must be an annuity to be within priority category four.

Although the only right of the lump sum claimants with less than five years service is to receive a single payment upon termination of service, section 10.1 of the plan defines their Total Accrued Benefit in terms of an annuity. Their rights are to receive a lump sum portion of their Total Accrued Benefit. I hold the lump sum claimants' benefits, which are expressed as an annuity in the Plan (the Employee Accrued Benefit), fall within priority category four of § 1344.[2]

In its brief, the PBGC raises a question regarding a residual value of the lump sum claims and into which priority category that residue would fall. Their position apparently is based on the fact the Plan provides a conversion rate utilizing a 5% interest factor which is substantially below current market rates and conversion into current market values will produce higher values. That is true for all benefits in the Plan. My holding that lump sums are expressed as an annuity under the Plan is solely for the purpose of determining into which priority

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[2] Benefits in any category are offset to the extent they fall within a higher priority category.

category the lump sum benefits belong. A lump sum which is converted into an annuity is equal to the lump sum so long as the conversion factors (interest rate and time) remain constant. It therefore has no residual value. The fact the lump sum may have a higher value on the commercial market than its value computed with plan factors is not relevant in determining its priority category.[3]

PANAGRA

At the time the debtor merged with Panagra in 1967, Panagra had a pension plan for its pilots. Under the merger agreement the Panagra plan was merged into the Braniff plan effective January 1, 1968. Assets from the Panagra plan were used to purchase a commercial annuity to provide the employee accrued benefits of all Panagra pilots. All assets of the Panagra plan in excess of those used to purchase the annuity became part of the debtor's plan and the Panagra plan ceased to exist. One of the merger terms was that all Panagra pilots became members of the Plan and were given credit for their service with Panagra. Since 1968 the Panagra pilots have accumulated additional benefits under the Plan by reason of their increased years of service and because of periodic increases to the benefits in the Plan. All Panagra pilots will therefore receive benefits in excess of those in the Panagra plan. The annuity alone is insufficient to pay these increased benefits to the Panagra pilots. The Panagra pilots seek to have this annuity segregated for their exclusive benefit and participate in the allocation of the other plan assets. To grant the Panagra pilots' request would effectively give them a proportionally greater share

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[3] Perhaps, under some circumstances it could be argued that the *right* to claim a lump sum is a benefit having a value in addition to the actual lump sum. That argument has no application here because of my holding that no right to a lump sum payment exists upon termination.

of plan assets than the other participants. This, of course, disrupts the allocation priorities of § 1344. The evidence is undisputed that the Panagra pilots will receive more in the allocation process by treating the annuity as part of the Plan's assets than they would receive under the annuity alone. They have demonstrated no inequities because of their position. On the other hand, it would be inequitable to all other participants to give the Panagra pilots preferential treatment. The fact that a portion of the Plan's assets is the annuity purchased with the Panagra plan's assets is immaterial. See Treas. Reg. § 1.414(1)-1(b)(1). Participants' of defined benefit plans have rights to defined benefits from the entire unallocated trust fund, not from specific plan assets. The Panagra pilots claim to specific plan assets will be denied.

MARITAL STATUS

Section 9.4 of the plan provides a retirement income benefit in the form of an annuity to eligible spouses who survive participants. This is a "subsidized" benefit as the plan rather than the individual participant bears the cost.[4] The Plan defines an "eligible spouse" as one that was legally married to the participant at the time of the participant's death and for at least the prior twelve months. Not all participants are married. The marital status and identity of the spouses of any participant may change before their death. Therefore, at this time, it is impossible to ascertain the identity and age of "eligible spouses". Because commercial annuities are priced on an actuarial basis, the plan administrator has been unable to obtain any bids for such annuities as a result of its inability to furnish prospective bidders with actuarial data on participants' "eligible spouses". As a solution, the plan administrator has proposed that the court modify

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[4] A "non-subsidized" survivorship benefit is one where the participant, usually through a reduction in their annuity, bears the cost of the benefit.

the definition of "eligible spouses" and limit it to spouses married to participants at the date of plan termination, which I have established as August 30. Such a change will affect three groups of participants: (1) Those who are single on August 30 and married at the time of their death; (2) those who are married on August 30 but are remarried to a younger spouse at the time of their death; and, (3) those who are married on August 30 but are remarried to an older spouse at the time of their death. Group three suffers no adverse consequences as a result of the proposed solution. Group two's adverse consequences will depend upon the age difference of the respective spouses. The actuary testified there would be little impact on the first group, those single on August 30 and married at the time of their death, because of the manner in which the calculations are made to value a participant's benefits. Benefits of single participants are given a higher value than married ones because of this survivorship feature. In the actuary's opinion this would approximately offset any inequality of treatment in most cases. None of the parties objected to this modification, but no one agreed to it, therefore leaving it for the court to decide. This problem was not contemplated when the plan was written. On the basis of the need for such modification and the general lack of inequities caused by it I will order the modification proposed by the plan administrator. This ruling does not preclude any participant from arranging for a non-subsidized survivorship benefit upon such terms as may be negotiated with the insurance carrier providing the annuity.

During trial a question arose as to the sufficiency of the notice given all class members and whether they were given adequate notice of the issues relating to the Panagra pilots and the surviving spouses. In the interest of due process the debtor will send another notice to all class members advising them of the existence of these issues. On those two issues I will enter an order which

will be conditioned upon consideration of any interests that may arise as a result of the notice. On all other issues I will enter a final order.

Dated in Fort Worth, Texas on the 22nd day of December, 1982.

/s/ John Flowers
JOHN FLOWERS
U.S. Bankruptcy Judge

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
FORT WORTH DIVISION

Miscellaneous No. 4-225-E

[Filed Jun. 28, 1983]

W. P. McDONALD

vs.

BRANIFF AIRWAYS, INCORPORATED, *et al.*

MEMORANDUM OPINION AND ORDER

This is an appeal from an order of the United States Bankruptcy Court for the Northern District of Texas entered January 28, 1983. That order involved pension plans of Braniff Airways, Inc. ("Braniff") and as a "related proceeding," *see* 29 U.S.C. § 1303(f), must be reviewed *de novo* by this Court under § d(3) of the Local Rule of the Northern District of Texas concerning Bankruptcy Cases and Procedures. Having carefully considered the supporting briefs, oral arguments, and applicable law, the Court has concluded that the order of the Bankruptcy Court should be affirmed.

I. *Facts*

The facts underlying this appeal are not in dispute. On November 3, 1976, Braniff and the Airline Pilots

Association ("ALPA") signed a collective bargaining agreement effective as of December 1, 1976. The collective bargaining agreement provided that the "A" Fund minimum for all pilots retiring on or after August 1, 1976 would be increased to $16,400 at 20 years of service, plus an additional $250 per year for each additional year of service over 20, effective January 1, 1978 ("the $16,400 formula") and the "A" Fund minimum for all pilots retiring on or after August 1, 1976 would be recalculated to be equal to 40% of the best 12 consecutive months of the last 60 months of compensation prior to retirement (with an option to drop certain months), effective May 1, 1979 ("the 40% formula").

As of either August 23 or 30, 1977 the terms of the "plan document" of the Braniff Airways, Incorporated Retirement Plan for Pilots provided an annual minimum benefit of $14,400 plus $250 for each year of service over 20 ("the $14,400 formula"). Braniff and ALPA signed an agreement on June 27, 1978 implemented the November 3, 1976 collective bargaining agreement in a formal plan amendment which was approved by the Braniff Board of Directors on August 29, 1978.

II. *Proper Method of Calculation*

The sole issue in this appeal involves the proper method of calculating priority category three benefits under Section 4044 of the Employee Retirement Income Security Act of 1974, ("ERISA") 29 U.S.C. § 1344.

Upon termination of a "defined benefit" plan, ERISA provides a mandatory statutory scheme of allocation of benefits into six categories. If the allocation shows that the assets of the plan are insufficient to satisfy all benegts thorugh category 4A, Pension Benefit Guaranty Corporation steps in to supplement the plan's assets to provide guaranteed benefits under 29 U.S.C. § 1322.

29 U.S.C. § 1344(a)(3) provides a third priority in the allocation of pension plan assets for benefits payable as an annuity:

> (A) in the case of the benefit of a participant or beneficiary which was in pay status as of the beginning of the 3-year period ending on the termination date of the plan, to each such benefit, based on the provisions of the plan (as in effect during the 5-year period ending on such date) under which such benefit would be the least,
>
> (B) in the case of a participant's or beneficiary's benefit (other than a benefit described in subparagraph (A)) which would have been in pay status as of the beginning of such 3-year period if the participant had retired prior to the beginning of the 3-year period and if his benefits had commenced (in the normal form of annuity under the plan) as of the beginning of such period, to each such benefit based on the provisions of the plan (as in effect during the 5-year period ending on such date) under which such benefit would be the least.
>
> For purposes of subparagraph (A), the lowest benefit in pay status during a 3-year period shall be considered the benefit in pay status for such period.

PGBC issued a regulation to clarify these provisions. 29 C.F.R. § 2618.13(b) (1982 provides:

> (b) Assigning benefits. The annuity benefit that is assigned to priority category 3 with respect to a participant is the lowest annuity that was paid or payable under the rules in paragraphs (b)(2) through (b)(6) of this section.
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> * * * *
>
> (2) Plan provisions governing determination of benefit. In determining the amount of the priority category 3 annuity with respect to a participant, the plan administrator shall use

the participant's age, service, actual or expected retirement age, and other relevant facts as of the following dates:

(i) Except as provided in the next sentence, for a participant or beneficiary whose benefit was in pay status before the beginning of the 3-year period ending on the date of plan termination, the priority category 3 benefit shall be determined according to plan provisions in effect on the date the benefit commenced. Benefit increases that became effective before the beginning of the 5-year period ending on the date of plan termination, including automatic benefit increases after that date to the extent provided in paragraph (b)(5) of this section, shall be included in determining the priority category 3 benefit. The form of annuity elected by a retiree is considered the normal form of annuity for that participant.

* * * *

(5) Automatic benefit increases. If plan provisions adopted and effective before the beginning of the 5-year period ending on the date of plan termination provided for automatic increases in the benefit formula for both active participants and those in pay status or for participants in pay status only, the lowest annuity benefit payable during the 5-year period ending on the date of plan termination determined under paragraph (b)(3) of this section includes the automatic increases scheduled during the fourth and fifth years preceding termination, subject to the following restrictions. Benefit increases for active participants in excess of the increases for retirees shall not be taken into account.

Appellant McDonald asserts that the 40% formula should be used for determination of category three benefits because it is an "automatic benefit increase" as defined above. Appellees contend that the regulation regarding "automatic benefit increases" should be interpreted to mean increases for *all* retirees in a plan. The increases of the $16,400 formula and the 40% formula were only applicable to those persons retiring on or after August 1, 1976, and there were, in fact, persons in pay status as of August 1, 1976 under the Plan who were not entitled to those benefit increases.

The Court considers the proper construction of 29 C.F.R. § 2618.13(b)(5) to mean benefit increases for *all* retirees of the Plan. This conclusion is supported both by the common understanding of the words "those in pay status" to include the entire class of retirees, and by the interpretation offered by appellee PBGC, which is charged with the responsibility of interpreting and administering Title IV of ERISA, under the express Congressional authorization of 29 U.S.C. § 1302(b)(3), 1322(b)(4)(A) (1976 and Supp. IV 1980). *See Red Lion Broadcasting Co. v. FCC*, 395 U.S. 367, 381 (1969); *Connolly v. PBGC*, 581 F.2d 729, 730 (9th Cir. 1978) *cert. denied*, 440 U.S. 935 (1979); *SEC v. Talley Industries*, 399 F.2d 396, 403 (2nd Cir. 1968).

Thus, the $16,400 formula and 40% formula should not be applied in calculating category three benefits. Having made this determination, the Court need not determine whether the plan provisions at issue were both "adopted and effective" before the beginning of the five year period ending on the date of the plan termination.

The order of the United States Bankruptcy Court for the Northern District of Texas entered January 28, 1983 requiring calculation of category three benefits by the $14,400 formula is hereby AFFIRMED.

Signed this 28 day of June, 1983.

/s/ ELDON B. MAHON
United States District Judge

APPENDIX C

SUPREME COURT OF THE UNITED STATES

No. A-1070

W. P. McDONALD,
Petitioner,

v.

BRANIFF AIRWAYS, INC., *et al.*

ORDER EXTENDING TIME TO FILE PETITION FOR WRIT OF CERTIORARI

UPON CONSIDERATION of the application of counsel for petitioner,

IT IS ORDERED that the time for filing a petition for writ of certiorari in the above-entitled cause be, and the same is hereby, extended to and including August 6, 1984.

/s/ Byron R. White
Associate Justice of the Supreme
Court of the United States

Dated this 5th
day of July, 1984.

APPENDIX D

29 USC § 1344

(a) In the case of termination of a single-employer defined benefit plan, the plan administrator shall allocate the assets of the plan (available to provide benefits) among the participants and beneficiaries of the plan in the following order:

(1) First, to that portion of each individual's accrued benefit which is derived from the participant's contributions to the plan which were not mandatory contributions.

(2) Second, to that portion of each individual's accrued benefit which is derived from the participant's mandatory contributions.

(3) Third, in the case of benefits payable as an annuity—

(A) in the case of the benefit of a participant or beneficiary which was in pay status as of the beginning of the 3-year period ending on the termination date of the plan, to each such benefit, based on the provisions of the plan (as in effect during the 5-year period ending on such date) under which such benefit would be the least,

(B) in the cause of a participant's or beneficiary's benefit (other than a benefit described in subparagraph (A) which would have been in pay status as of the beginning of such 3-year period if the participant had retired prior to the beginning of the 3-year period and if his benefits had commenced (in the normal form of annuity under the plan) as of the beginning of such period, to each such benefit based on the provisions of the plan (as in effect during the

5-year period ending on such date) under which such benefit would be the least.

For purposes of subparagraph (A), the lowest benefit in pay status during a 3-year period shall be considered the benefit in pay status for such period.

APPENDIX E

29 CFR § 2618.13

§ 2618.13 Priority category 3 benefits.

(a) *Definition.* The benefits in priority category 3 are those annuity benefits that were in pay status before the beginning of the 3-year period ending on the date of plan termination, and those annuity benefits that could have been in pay status for participants who were eligible to receive annuity benefits before the beginning of the 3-year period ending on the date of plan termination. Benefits are primarily basic-type benefits, although nonbasic-type benefits will be included if any portion of a participant's priority category 3 benefit is not guaranteeable under the provisions of Part 2613 of this chapter.

(b) *Assigning benefits.* The annuity benefit that is assigned to priority category 3 with respect to a participant is the lowest annuity that was paid or payable under the rules in paragraphs (b) (2) through (b) (6) of this section.

(1) *Eligibility of participants and beneficiaries.* A participant or beneficiary is eligible for a priority category 3 benefit if either of the following applies:

(i) The participant's (or beneficiary's) benefit was in pay status before the beginning of the 3-year period ending on the date of plan termination.

(ii) The participant was eligible for an annuity and his or her benefit could have been in pay status before the beginning of the 3-year period ending on the date of plan termination. Whether a participant was eligible to receive an annuity before the beginning of the 3-year period shall be determined using the plan provisions in effect on the day before the beginning of the 3-year period.

(iii) If a participant described in either of the preceding two paragraphs died during the 3-year period ending on the date of the plan termination and his or her beneficiary is entitled to an annuity, the beneficiary is eligible for a priority category 3 benefit.

(2) *Plan provisions governing determination of benefit.* In determining the amount of the priority category 3 annuity with respect to a participant, the plan administrator shall use the participant's age, service, actual or expected retirement age, and other relevant facts as of the following dates:

(i) Except as provided in the next sentence, for a participant or beneficiary whose benefit was in pay status before the beginning of the 3-year period ending on the date of plan termination, the priority category 3 benefit shall be determined according to plan provisions in effect on the date the benefit commenced. Benefit increases that became effective before the beginning of the 5-year period ending on the date of plan termination, including automatic benefit increases after that date to the extent provided in paragraph (b)(5) of this section, shall be included in determining the priority category 3 benefit. The form of annuity elected by a retiree is considered the normal form of annuity for that participant.

(ii) For a participant who was eligible to receive an annuity before the beginning of the 3-year period ending on the date of plan termination but whose benefit was not in pay status, the priority category 3 benefit and the normal form of annuity shall be determined according to plan provisions in effect on the day before the beginning of the 3-year period ending on the date of plan termination as if the benefit had commenced at that time.

(3) *General benefit limitations.* The general benefit limitation is determined as follows:

(i) If a participant's benefit was in pay status before the beginning of the 3-year period, the benefit assigned to

priority category 3 with respect to that participant is limited to the lesser of the lowest annuity benefit in pay status during the 3-year period ending on the date of plan terminations and the lowest annuity benefit payable under the plan provisions at any time during the 5-year period ending on the date of plan termination.

(ii) Unless a benefit was in pay status before the beginning of the 3-year period ending on the date of plan termination, the benefit assigned to priority category 3 with respect to a participant is limited to the lowest annuity benefit payable under the plan provisions, including any reduction for early retirement, at any time during the 5-year period ending on the date of plan termination. If the annuity form of benefit under a formula that appears to produce the lowest benefit differs from the normal annuity form for the participant under paragraph (b)(2)(ii) of this section, the benefits shall be compared after the differing form is converted to the normal annuity form, using plan factors. In the absence of plan factors, the factors in Part 2621 of this chapter shall be used.

(iii) For purposes of this paragraph, if a terminating plan has been in effect less than five years on the date of plan termination, computed in accordance with paragraph (b)(6) of this section, the lowest annuity benefit under the plan during the 5-year period ending on the date of plan termination is zero. If the plan is a successor to a previously established defined benefit plan within the meaning of section 4021(a) of the Act, the time it has been in effect will include the time the predecessor plan was in effect.

(4) *Determination of beneficiary's benefit.* If a beneficiary is eligible for a priority category 3 benefit because of the death of a participant during the 3-year period ending on the date of plan termination, the benefit assigned to priority category 3 for the beneficiary shall be

determined as if the participant had died the day before the 3-year period began.

(5) *Automatic benefit increases.* If plan provisions adopted and effective before the beginning of the 5-year period ending on the date of plan termination provided for automatic increases in the benefit formula for both active participants and those in pay status or for participants in pay status only, the lowest annuity benefit payable during the 5-year period ending on the date of plan termination determined under paragraph (b)(3) of this section includes the automatic increases scheduled during the fourth and fifth years preceding termination, subject to the following restrictions. Benefit increases for active participants in excess of the increases for retirees shall not be taken into account.

(6) *Computation of time periods.* For purposes of this section, a plan or amendment is "in effect" on the later of the date on which it is adopted or the date it becomes effective.

[46 FR 9485, Jan. 28, 1981; 46 FR 10720, Feb. 2, 1981. Redesignated and amended at 46 FR 32575, June 24, 1981]

APPENDIX F

IN THE UNITED STATES BANKRUPTY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
FORT WORTH DIVISION

Case. No. 482-00369

Adversary No. 482-0337

IN RE BRANIFF AIRWAYS, INC., *et al.*,
Debtors

BRANIFF AIRWAYS, INC., AIR LINE PILOTS ASSOCIATION, INTERNATIONAL; BRANIFF AIRWAYS, INC., RETIREMENT PLAN FOR PILOTS, Part A; DALE STATES, JACK BOISEN, JOHN SKIBA and RICHARD RUSSELL, constituting the RETIREMENT BOARD OF BRANIFF AIRWAYS, INC. RETIREMENT PLAN FOR PILOTS, Part A,
Plaintiffs

v.

BANKERS TRUST COMPANY AS TRUSTEE; and W. P. MCDONALD, DANIEL P. HULSEY, GERALD S. ROSS and N.G. ROBSON and V.A. QUATTLEBAUM on their own behalf and on behalf of all PLAN BENEFICIARIES and PENSION BENEFIT GUARANTY CORPORATION,
Defendants

Memorandum Opinion [1]

In this adversary proceeding the Debtor is seeking a court ordered date for the termination of its pension

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[1] This opinion is substituted for the one rendered December 8, 1982 to correct a misstatement of the facts. The result remains the same.

plan pursaunt to 29 U.S.C. § 1348 of the Employee Retirement Income Security Act ("ERISA").

Under ERISA the Pension Benefit Guaranty Corporation ("PBGC") guarantees certain levels of payment to participants of pension plans. The guaranty extends through the first four statutory categories defined in 29 U.S.C. § 1344. The issue presented at the outset concerns the formula by which category three benefits are to be computed. That issue has relevance to the date of termination because the statutory provisions regarding termination procedure are dependant upon whether the plan is sufficient or insufficient. (See my memorandum opinion of November 9, 1982 dealing with the termination date for the Retirement Plan for Management Employees of Braniff Airways, Incorporated.) A plan is sufficient when it has sufficient assets to pay the first four guaranteed statutory levels. All parties agree that if one formula is utilized the plan is sufficient; if another, it is insufficient. The PBGC contends the court should not concern itself with the formula upon which category three benefits are calculated until the PBGC has ruled on the matter administratively. However, in this case the question of sufficiency and the date of termination are inextricably linked thus requiring my decision on this point.

The undisputed facts are that there were different benefit levels being paid to eligible pilots in the three year period prior to termination: (1) Benefits calculated on a formula of $14,400 for those pilots who retired before August, 1976; (2) Benefits calculated on a formula of $16,400 for those who retired after January 1, 1978 which escalated automatically for this group to a 40% formula on May 1, 1979. Thus, depending upon his date of retirement an eligible pilot is paid amounts based upon either the 40% or the $14,400 formula. These automatic increases were the result of the pilots' collective bargaining agreement and were part of the plan within five

years of any possible termination date which might be selected by the court.

The statutory provisions in question provide:

> (a) In the case of the termination of a single-employer defined benefit plan, the plan administrator shall allocate the assets of the plan (available to provide benefits) among the participants and beneficiaries of the plan in the following order:
>
> * * * *
>
> (3) Third, in the case of benefits payable as an annuity—
>
> (A) In the case of the benefit of a participant or beneficiary which was in pay status as of the beginning of the three-year period ending on the termination of the plan, to each such benefit, based on the provisions of the plan (as in effect during the 5-year period ending on such date) under which such benefit would be the least,
>
> * * * *
>
> For the purposes of subparagraph (A), the lowest benefit in pay status during a three year period shall be considered the benefit in pay status for such period.
>
> 29 U.S.C. § 1344.

The PBGC has issued Regulation § 2618 interpreting this statute. The pertinent part of this regulation provides:

> (a) Definition. The benefits in priority category 3 are those annuity benefits that were in pay status before the beginning of the 3-year period ending on the date of plan termination and those annuity benefits that could have been in pay status. . .
>
> * * * *
>
> (b) Assigning benefits. The annuity benefit that is assigned to priority category 3 with respect to a

participant is the lowest annuity that was paid or payable under the rules in Paragraphs (b)(2) through (b)(6) of this section.

* * * *

(5) Automatic benefit increases. If plan provisions adopted and effective before the beginning of the 5-year period ending on the date of plan termination provided for automatic increases in the benefit formula for both active participants and those in pay status or for participants in pay status only, the lowest annuity benefit payable during the 5-year period ending on the date of plan termination determined under Paragraph (b)(3) of this section includes the automatic increases scheduled during the forth and fifth years preceding termination, subject to the following restrictions. Benefit increases for active participants in excess of the increases for retirees shall not be taken into account.

§ 2618(a), (b), (b)(5)

One sub-class of defendants represented by the defendant, McDonald, asserts the proper formula to determine category three benefits is the 40% formula because it was "in effect" during the relevant period. If the 40% formula is selected as the proper formula the plan becomes insufficient. Under the $14,400 formula the plan is sufficient. McDonald's argument is based upon paragraph (b)(5) of the regulation which contains the rule for automatic increases such as are involved here. He argues the statute is incomprehensible and focuses on the absence of the word "all" in the regulation when referring to increased benefits for participants in pay status. From this he contends the term "lowest annuity" must be the one resulting from the application of the 40% formula because it was an "automatic increase scheduled during" the relevant period payable to some of the participants in pay status. The omission of the word "all" is not crucial here because the regulation refers to in-

creases for "those is pay status." Such language clearly implies *all* of those in pay status, not some or a portion as McDonald urges. The lead-in phrase to subdivision (b) expressly provides that category three is to be the *lowest* annuity under paragraphs (b)(2) through (b)(6). The statute also deals with the possibility that there may be more than one level of benefits paid to participants during the relevant period. The least benefit during the five year period is specified as the category three benefit. The relevant section concludes with the requirement that it be the lowest paid in the three year period. Those provisions apply to the situation presented here.[2]

Although not models of clarity, the intent of both the statute and the regulation is that the lowest annuity paid or payable is to be used. Of the various formulas in effect, the $14,400 formula is obviously the lowest and accordingly is the one to be used to determine category three benefits.

/s/ John Flowers
JOHN FLOWERS
U.S. Bankruptcy Judge

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[2] Although not an issue here, the regulation may be inconsistent with the statute in those cases where all participants in pay status receive an automatic increase within three years of termination. They would have been paid at different levels of benefits and under the regulation the highest level would seem to be the proper one.